

Private Letter Ruling: Petition to apply 86 Ill. Admin. Code Section 100.3380(d) to taxable years beginning prior to its effective date is granted.

January 26, 2005

Dear:

This is in response to your letter dated October 5, 2004, in which you request a Private Letter Ruling on behalf of COMPANY1. The Private Letter Ruling will bind the Department only with respect to COMPANY1 for the issue or issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that neither COMPANY1 nor a related taxpayer is currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them in your letter are as follows:

Pursuant to IITA Regulations Section 100.3390, we are hereby petitioning the Director for a change in accounting method from the "separate accounting" method (erroneously used for filing its original 1999, 2000 and 2001 IL-1065) to the "alternative apportionment" method for determining IL source income (as used on the attached *amended* 1999 IL-1065 and to be amended 2000 and 2001 IL-1065 in accordance with IITA Reg. Sec. 100.3390(e)(2)). We are petitioning for this change because we do not believe that the original, separate accounting, method of filing was correct for a unitary partnership nor does it accurately reflect COMPANY1's business activity in Illinois. We believe, however, that an alternative apportionment method, i.e. apportionment of business income based on a sales factor as defined by IITA Sec. 304(a)(3), correctly and accurately reflects COMPANY1's business activity within Illinois.

In accordance with IITA Section 304(e), "where 2 or more persons are engaged in a unitary business as described in subsection (a)(27) of Section 1501, a part of which is conducted in this State by one or more members of the group, the business income attributable to this state by any such member or members shall be apportioned by means of the combined apportionment method". Further, IITA Sec. 1501(a)(27) states that "Unitary business activity can ordinarily be illustrated where the activities of the members are: (1) in the same general line ...; or (2) are steps in a vertically structured enterprise or process ...; and, in either instance, the members are functionally integrated through the exercise of strong centralized management". COMPANY1 is a unitary business with its underlying partnerships because they are in the same general line of business and are functionally integrated through the exercise of strong centralized management as well as the pooling of common resources.

Unitary Business

COMPANY1 is a family owned general partnership, organized under the laws of Florida, and made up of four individual family members (a mother and her three grown children) who are German citizens/residents. The four family members share in the profits, losses and ownership on an equal basis. COMPANY1 has contracted with both COMPANY2, general partner of the lower-tier partnerships, and COMPANY3 to manage the many lower-tier limited partnerships, in which it owns its 98/99% interest.

COMPANY2 and COMPANY3 manage no other commercial real estate businesses other than that owned by the Family.

The tax matters partner of COMPANY1 is also the 49% owner of COMPANY3 and the 20% owner of COMPANY2, as well as a director and board member of both corporations. The remaining partners of COMPANY1 are also 20% owners of COMPANY2. The remaining 20% owner of COMPANY2 as well as the 51% owner of COMPANY3 is the father of the family, who is no longer required to file a US income tax return. All of the four partners of COMPANY1 file Form 1040NR as well as the following state returns: AZ, CA, IL, GA, CT, NJ and PA. In addition to the states where these entities file, we also have property in FL and TX, but as individuals have no filing requirements.

COMPANY1, COMPANY2, COMPANY3 and the lower-tier partnerships, on a consolidated basis, constitute the U.S. commercial real estate business of the Family. All business decisions are made on such a consolidated basis with the businesses reporting on a consolidated GAAP financial statement basis. This consolidated group is in the business of acquiring, developing, investing, leasing, and maintaining commercial real property for the purpose of generating income on a regular basis.

Each of COMPANY1, COMPANY2 and COMPANY3 has its own Board of Directors, with members of each board also being members of the other. These boards hold common annual meetings and conduct business as a consolidated group. Each of these entities is governed by a common set of "Rules of Internal Procedure" as well as "Table of Corporate Authority". The president of COMPANY3, Mr. Z, and the president of COMPANY2, Mr. Y, both reside in Florida and have offices located in CITY1, Florida. Both presidents have daily/weekly communications with the German owners. The presidents also have weekly meetings, amongst themselves and their vice-presidents, to update everyone on the individual status of various projects. All total there are two presidents, three vice-presidents and nine staff members working out of the CITY1 area. All of the vice-presidents as well as the staff report equally to both presidents and are responsible for the day-to-day accounting and administrative tasks necessary for maintaining COMPANY1's business. Some of these vice-presidents are dual officers of both corporations. Additionally, there are twelve staff members, employed under the name of COMPANY3, housed in CITY2, California, who also report equally to both presidents. These people are predominately responsible for the daily management of the shopping centers located in Southern California and Arizona. The daily management of the office buildings and one retail complex in Pennsylvania are under contract to COMPANY4, who is in daily communication with/supervision by the CITY1 office. All of the accounting records and network systems for all of the entities/properties is maintained in the CITY1 office. Historically, COMPANY1 has not had any direct employees, mostly for legal liability reasons.

When new ventures are found, the presidents discuss such ventures with each other before going forward. Generally, Mr. Z has oversight over the office portfolio and Mr. Y

has oversight over the retail portfolio. This is mainly for convenience purposes as Mr. Zs' background involves office buildings and Mr. Y's involves retail centers. Even though there is this assignment among the presidents, it is understood that there is dual management control among the presidents. In fact, in much of our corporate documentation, there is referred to a "four-eyes" policy, which indirectly means the dual oversight of both presidents. In general, the process of making business decisions internally is consolidated, based on economic analysis and feasibility/profitability for the group as a whole; it is only after the decision is made to go forward do we stop to think what is the best entity to accomplish our projected goals. After such decisions are made, all legal documents must be signed by at least two officers, preferably both presidents.

All of the cash generated by the lower-tier partnerships is controlled by the centralized management in CITY1, Florida, under a common bank account entitled "COMPANY3 as agent for COMPANY5". Presidents, as well as vice presidents and other designated persons, have signatory authority over these funds. When investments are made, such as in short-term Federal agencies and notes, the pooled cash is used to purchase instruments under the same name "COMPANY3 as agent for COMPANY5". Any interest earned on these investments is allocated internally among the various partnerships based on their percentage of total cash used for the investment.

Historically most of our acquisitions have been made from available pooled cash. Thus, when cash is needed in a new partnership to fund the acquisition of a new building or shopping center, funds are distributed up to COMPANY2 and COMPANY1 and then contributed to the new or existing partnership for the acquisition. Within the last few years, many of our major office buildings and one of our new retail centers have been acquired via the use of debt. Typically debt is extended to a partnership that has no debt, then, in a debt financed distribution, funds are distributed to COMPANY2 and COMPANY1, who in turn contribute the funds where needed for the acquisition. In other words, funds acquired through the use of debt instruments are also pooled in order to carry out the wishes of the owners, i.e. acquisition, or for general business purposes.

Lastly, because of the value and size of the total portfolio, policies such as insurance are purchased on a portfolio-wide basis. Currently, there exists a blanket liability policy over all the properties, both office and retail, which is paid out of the general COMPANY3 as agent for COMPANY5 account and the cost is internally allocated to the various properties based on management experience.

Apportionment

Pursuant to IITA Regulation Section 100.3380(d), "when the business activities of a partnership and any of its partners' business activities constitute a unitary business, the partner's distributive share of the business income and apportionment factors of the partnership shall be included in that partner's business income and apportionment

factors". Thus, because COMPANY1 is a unitary business with its underlying partnerships, its distributive share of the factors of the underlying partnerships should be used in its determination of its IL source income and that of its partners, the Mann Family members.

Based on the above discussion, we believe that COMPANY1's common ownership of all partnership interests in the common commercial real estate business, strong centralized management of operations, and pooling of resources to accomplish overall goals of the business, all support COMPANY1's assertion of a unitary business subject to the rules of apportionment in Illinois. As such, COMPANY1 hereby requests that the Director approve its request to correct its erroneous use of the separate accounting method and change to the alternative apportionment method for filing its amended 1999 IL-1065 return and to be amended 2000 and 2001 IL-1065 returns.

Based on the Illinois auditor's unitary finding for COMPANY1 during the 2001 and prior audits, COMPANY1 has filed unitary 2002 and 2003 IL-1065 returns with its lower tier partnerships and apportioned its corresponding business income based on a single sales factor under IITA Sec. 304(a)(3).

Ruling

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Pursuant to this provision, the Department promulgated 86 Ill. Admin. Code Section 100.3380(d)(2), which provides that:

when the business activities of a partnership and any of its partners' business activities constitute a unitary business:

- A) The partner's distributive share of the business income and apportionment

factors of the partnership shall be included in that partner's business income and apportionment factors. In determining the business income and apportionment factors of the partnership, transactions between the unitary partner and the partnership shall not be eliminated.

This provision became effective on June 20, 2002. 86 Ill. Admin. Code Section 100.3380(a) provides:

For tax years beginning on or after the effective date of a rulemaking amending this Section to prescribe a specific method of apportioning business income, all nonresident taxpayers are directed to apportion their business income employing that method in order to properly apportion their business income to Illinois. Taxpayers whose business activity within Illinois is not fairly represented by a method prescribed in this Section and who do not want to use that method for a tax year beginning_ after the effective date of the rulemaking adopting that method must file a petition under Section 100.3390 of this Part requesting permission to use an alternative method of apportionment. For tax years beginning prior to the effective date of the rulemaking adopting a method of apportioning business income, the Department will not require a taxpayer to adopt that method; provided, however, if any taxpayer has used that method for any such tax year, the taxpayer must continue to use that method that tax year. Moreover, a taxpayer may file a petition under Section 100.3390 of this Part to use a method of apportionment prescribed in this Section for any open tax year tax year beginning prior to the effective date of the rulemaking adopting that method, and such petition shall be granted in the absence of facts showing that such method will not fairly represent the extent of a person's business activity in Illinois.

Based on your representation that COMPANY1 is engaged in a unitary business with each of the partnerships in which it is a partner, 86 Ill. Admin. Code Section 100.3380(d) requires COMPANY1 to include in its business income and apportionment factors its partnership share of the business income and apportionment factors of each partnership for all taxable years beginning after June 20, 2002. 86 Ill. Admin. Code Section 100.3380(a) provides that, for prior years, the Department will grant COMPANY1 permission to use this method of apportionment if it files a petition under 86 Ill. Admin. Code Section 100.3390 and there are no facts indicating that the use of this method of apportionment would fail to fairly represent COMPANY1's business activity in Illinois. Also, if a taxpayer has used an apportionment method prescribed in a provision of 86 Ill. Admin. Code Section 100.3380 prior to the provision's effective date, it must continue to do so.

Because no facts indicating that the apportionment method prescribed in 86 Ill. Admin. Code Section 100.3380(d) will fail to fairly represent COMPANY1's business activity in Illinois, 86 Ill. Admin. Code Section 100.3380(a) requires the granting of its petition to use that method in the years in question.

Grant of Section 304(f) Petition

The petition of COMPANY1 under Section 304(f) of the IITA to use the alternative apportionment formula described in this ruling is hereby granted, and COMPANY1 may use that apportionment

formula for Illinois Income Tax returns due its taxable years ending on or after December 31, 1999.

The facts upon which this ruling are based are subject to review by the Department during the course of any audit, investigation or hearing and this ruling shall bind the Department only if the material facts as recited in this ruling are correct and complete. This ruling will cease to bind the Department if there is a pertinent change in statutory law, case law, rules or in the material facts recited in this ruling.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax